Problem 3

Euro Air company issued $500,000 of 5-year bonds. The bonds were issued at par on January 1, 20X1, and bear interest at a rate of 5% per annum, payable semiannually.

a) Prepare the journal entry to record the bond issue on January, 20X1.
b) Prepare the journal entry that Euro Air would record on each interest date.
c) Prepare the journal entry that Euro Air would record at maturity of the bonds.
d) How much cash flowed "in" and "out" on this bond issued, and how does the difference compare to total interest expense that was recognized?

Worksheet 3

a), b), c)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Issue			
Interest			
Maturity			

d)

Solution 3

a), b), c)

GENERAL JOURNAL			
Date	**Accounts**	**Debit**	**Credit**
Issue	Cash	500,000	
	Bonds Payable		500,000
	To record the issuance of $500,000, 5%, 5-year bonds at par – interest payable semiannually		
Interest	Interest Expense	12,500	
	Cash		12,500
	To record the payment of an interest payment ($500,000 par X .05 sinterest X 6/12 months)		
Maturity	Bonds Payable	500,000	
	Cash		500,000
	To record the redemption of bond investment at maturity		

d) Total cash inflow was $500,000, and total cash outflow was $625,000 (($12,500 × 10 periods) + $500,000). The $125,000 difference is equivalent to the interest expense that would be recognized over time ($12,500 × 10 periods).